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MANY KEY ISSUES STILL LEFT UNADDRESSED IN
THE SECURITIES AND EXCHANGE
COMMISSION'S ATTEMPT TO MODERNIZE
ITS RULES OF PRACTICE

*Joseph Quincy Patterson**

“By bringing more cases in its own backyard, the agency is not only increasing its chances of winning but giving itself greater control over the future evolution of legal doctrine.”

—Joseph Grundfest, former SEC Commissioner¹

INTRODUCTION

Towards the end of 2013, the Securities and Exchange Commission (SEC) lost three high-profile insider-trading cases in federal district court.² Shortly after, the SEC instituted a new policy in which it “signaled its intention to bring as administrative actions certain kinds of enforcement actions that historically it has more often brought in the federal courts.”³ This policy

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1 Jean Eaglesham, *SEC Wins with In-House Judges: Agency Prevails Against Around 90% of Defendants When It Sends Cases to Its Administrative Law Judges*, WALL ST. J. (May 6, 2015), <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803>.

2 See SEC v. Jensen, No. CV11-5316-R, 2013 WL 6499699, at *31 (C.D. Cal. Dec. 10, 2013) (holding that “[t]he SEC has not carried its burden of proof with respect to any of the causes of action in the Complaint”); Verdict Form, SEC v. Kovzan, No. 11-2017-JWL (D. Kan. Dec. 2, 2013) (Doc. 408); SEC v. Cuban, No. 3:08-CV-2050-D (N.D. Tex. Oct. 16, 2013); see also Hon. Jed S. Rakoff, U.S. Dist. Judge, S. Dist. of N.Y., PLI Securities Regulation Institute Keynote Address: Is the S.E.C. Becoming a Law unto Itself? 9–10 (Nov. 5, 2014), <https://securitiesdiary.files.wordpress.com/2014/11/rakoff-pli-speech.pdf> (“[T]his past year, the S.E.C. suffered stinging defeats in two such cases In both these cases, novel and difficult legal issues were presented that led initially to both cases being dismissed[,] . . . but the issues were ultimately resolved by appellate decisions favorable to the S.E.C.’s theories. Nonetheless[,] when . . . the cases were ultimately tried to juries, the S.E.C. lost.”).

3 Rakoff, *supra* note 2, at 2; see also Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, WALL ST. J. (Oct. 21, 2014), <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590> (quoting Kara Brockmeyer, the head of the SEC’s

included bringing complicated insider-trading cases before Administrative Law Judges (ALJs)⁴ rather than before a district court.⁵ The SEC claims that the change was due to “recent statutory changes,”⁶ resulting from the Dodd-Frank Wall Street Reform and Consumer Protection Act.⁷ By adding section 929P(a) to the previously enacted statutes, Congress authorized the SEC to seek civil monetary penalties against “any persons or entities” regardless of whether they are regulated by the SEC.⁸ The timing has caused some legal experts to question whether the reason had more to do with giving the SEC a home-court advantage.⁹ For instance, on May 7, 2015, the Wall Street Journal published an article, in which it criticized the SEC for its ninety-percent success rate before an ALJ as compared to a sixty-nine-percent success rate before a federal district court.¹⁰ By bringing cases in administrative proceed-

anti-foreign-corruption enforcement unit, as saying, “It’s fair to say it’s the new normal. . . . Just like the rest of the enforcement division, we’re moving towards using administrative proceedings more frequently.”); Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES (Oct. 5, 2013), http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html?_r=0 (quoting Andrew Ceresney, Director of the Division of Enforcement, SEC, as saying, “Our expectation is that we will be bringing more administrative proceedings given the recent statutory changes.”).

4 ALJs receive their authority “[u]nder the Administrative Procedure Act and the Commission’s Rules of Practice.” *Office of Administrative Law Judges*, U.S. SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/alj> (last visited Mar. 18, 2016). When the SEC’s Division of Enforcement brings an “Order Instituting Proceeding” before an ALJ, the duties of the ALJ consist of “taking evidence, determining whether the allegations are true, and issuing an initial decision within a specified time period.” *Id.*

5 Sarah N. Lynch, *U.S. SEC to File Some Insider-Trading Cases in Its In-House Court*, REUTERS (June 11, 2014), <http://www.reuters.com/article/2014/06/11/sec-insidertrading-idUSL2N00S1AT20140611> (quoting Andrew Ceresney, Director of the Division of Enforcement, SEC, as saying, “I do think we will bring insider-trading cases as administrative proceedings in appropriate cases”); *cf. id.* (quoting Stephen Crimmins, partner at K&L Gates and former SEC trial attorney as saying, “Prosecuting insider trading cases in administrative proceedings would be a significant change.”).

6 Morgenson, *supra* note 3.

7 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); *see also infra* notes 79–93 and accompanying text.

8 Dodd-Frank Wall Street Reform and Consumer Protection Act § 929P(a), 124 Stat. at 1862; *see also* Rakoff, *supra* note 2, at 5 (“Section 929P(a) [of the Dodd-Frank Act] gives the S.E.C. the power through internal administrative proceedings to impose substantial monetary penalties against any *person or entity* whatsoever if that person or entity has violated the federal securities laws, even if the violation was unintentional.” (emphasis added) (citing Dodd-Frank Wall Street Reform and Consumer Protection Act § 929P(a))). Historically, the SEC could not seek civil monetary penalties against non-regulated persons or entities unless they brought the proceeding in a federal district court. *Id.* at 4–5.

9 *See* William McLucas & Matthew Martens, Opinion, *How to Rein in the SEC*, WALL ST. J. (June 2, 2015), <http://www.wsj.com/articles/how-to-rein-in-the-sec-1433285747> (“One need not be a conspiracy theorist to wonder whether at least part of the SEC’s rationale was to avoid the federal courts.”).

10 *See* Eaglesham, *supra* note 1 (“The SEC won against 90% of defendants before its own judges in contested cases from October 2010 through March of this year. . . . That was markedly higher than 69% success the agency obtained against defendants in federal court

ings rather than federal district courts, the defendant loses many procedural rights that are guaranteed in federal district court, such as a right to a jury, full discovery rights under federal law, and the Federal Rules of Evidence.¹¹ This change in policy has many of the defendants who won a decision against the SEC before a jury to “doubt [they] would have been able to develop the facts that convinced the jury to find in [their] favor.”¹² Additionally, this change in policy by the SEC has led to an increase in the number of appeals questioning whether the procedures used by the SEC violate the defendants’ right to due process¹³ and whether the SEC properly appointed the ALJs according to Article II, section 2 of the United States Constitution, which states that “Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.”¹⁴

over the same period”); *see also* Rakoff, *supra* note 2, at 7 (“It is hardly surprising in these circumstances that the S.E.C. won 100% of its internal administrative hearings in the fiscal year ending September 30, 2014, whereas it won only 61% of its trials in federal court during the same period.”).

11 *See* Ryan Jones, Note, *The Fight over Home Court: An Analysis of the SEC’s Increased Use of Administrative Proceedings*, 68 SMU L. REV. 507, 523–28 (2015) (discussing the due process and equal protection issues related to the increased number of cases being brought in administrative proceedings as compared to federal district courts); *see also* Rakoff, *supra* note 2, at 7 (“S.E.C. administrative proceedings involve much more limited discovery than federal actions, with no provision whatsoever for either depositions or interrogatories. . . . [T]he Federal Rules of Evidence do not apply Further still, there is no jury, and the matter is decided by an [ALJ] appointed and paid by the S.E.C.”).

12 Jean Eaglesham, *SEC Gives Ground on Judges: Facing Criticism and Challenges, Agency Increases Defendants’ Legal Safeguards*, WALL ST. J. (Sept. 24, 2015), <http://www.wsj.com/articles/sec-gives-ground-on-judges-1443139425> (quoting Joel Cohen, a partner at Gibson, Dunn & Crutcher LLP, who successfully defended Nelson Obus in 2014 against the SEC); *see also* Brief of Mark Cuban as Amicus Curiae in Support of the Plaintiff-Appellee and Affirmance at 2, *Hill v. SEC*, No. 15-12831 (11th Cir. Oct. 29, 2015), 2015 WL 6653553, at *2 [hereinafter Cuban Amicus Brief] (“Had Mr. Cuban been subjected to the treatment the SEC intends for Mr. Hill, without the procedural safeguards available in federal district court before a presiding person with the stature and power to ensure fairness, Mr. Cuban likely would have been found liable by an in-house SEC ALJ on an untested legal theory and based on incomplete and misleading facts.”); Mark Cuban & Thomas Melsheimer, Opinion, *It Is Time to Rein in the SEC*, WASH. POST (Dec. 19, 2014), https://www.washingtonpost.com/opinions/it-is-time-to-rein-in-the-sec/2014/12/19/bb7b988c-86cd-11e4-b9b7-b8632ae73d25_story.html (“In an SEC home-court proceeding, we wouldn’t have had the right to take the deposition and to discover inconsistent testimony. And would a judge on the SEC payroll have been as persuaded as the jury was that the testimony was tainted by undue SEC influence? That hardly seems likely.”).

13 *See generally* Memorandum of Law in Support of Motion for Preliminary Injunction at 12–33, *Bebo v. SEC*, No. 15-CV-00003 (E.D. Wis. Jan. 23, 2015) [hereinafter *Bebo* Memorandum]; Plaintiffs’ Memorandum of Law in Further Support of Motion for Preliminary Injunction and in Opposition to the Securities and Exchange Commission’s Motion to Dismiss at 3–21, *Chau v. SEC*, No. 14-CV-01903-LAK (S.D.N.Y. June 5, 2014).

14 U.S. CONST. art. II, § 2; *see Bebo* Memorandum, *supra* note 13, at 34–42; Plaintiff’s Supplemental Brief in Support of Plaintiff’s Motion for a Temporary Restraining Order or,

These constitutional questions and the seeming home-court advantage awarded to the SEC when it brings cases before ALJs rather than before federal district courts have led to much criticism.¹⁵ For example, over the past few months, Jean Eaglesham has written multiple articles in the *Wall Street Journal* about the SEC's use of "in-house judges" and its high success rate.¹⁶ This negative publicity has some lawyers concerned that the general public will begin to question the fairness of all administrative proceedings.¹⁷ Additionally, the SEC's change in policy has many former SEC Commissioners, enforcement chiefs, and ALJs criticizing the expanded use of administrative proceedings.¹⁸ Some federal judges, including Supreme Court Justice

in the Alternative, a Preliminary Injunction at 4–14, *Hill v. SEC*, No. 15-CV-01801-LMM (N.D. Ga. June 8, 2015) [hereinafter *Hill Supplemental Brief*].

15 See Rakoff, *supra* note 2, at 1-2, 7; see also Cuban Amicus Brief, *supra* note 12, at 13 ("These procedures are woefully inadequate in complex securities fraud cases, such as insider trading cases, and even the SEC's General Counsel has recently acknowledged that it is reasonable to question whether the rules governing administrative proceedings are still appropriate and whether they should be updated.").

16 Jean Eaglesham, *Federal Judge Deals Another Blow to SEC Administrative Court*, WALL ST. J. (Aug. 5, 2015), <http://www.wsj.com/articles/federal-judge-deals-another-blow-to-sec-administrative-court-1438792993>; Jean Eaglesham, *Federal Judge Rules SEC In-House Judge's Appointment Likely Unconstitutional*, WALL ST. J. (June 8, 2015), <http://www.wsj.com/articles/federal-judge-rules-sec-in-house-judges-appointment-likely-unconstitutional-1433796161>; Jean Eaglesham, *SEC Ex-Enforcement Chief Calls for Reforms to In-House Judges*, WALL ST. J. (May 12, 2015), <http://www.wsj.com/articles/sec-ex-enforcement-chief-calls-for-reforms-to-in-house-judges-1431471223> [hereinafter Eaglesham, *Overhaul*]; Jean Eaglesham, *SEC Fights Challenges to Its In-House Courts*, WALL ST. J. (June 21, 2015), <http://www.wsj.com/articles/sec-fights-challenges-to-its-in-house-courts-1434927977> [hereinafter Eaglesham, *SEC Fights*]; Eaglesham, *supra* note 12; Jean Eaglesham, *SEC Trims Use of In-House Judges*, WALL ST. J. (Oct. 11, 2015), <http://www.wsj.com/articles/sec-trims-use-of-in-house-judges-1444611604> [hereinafter Eaglesham, *SEC Trims*]; Eaglesham, *supra* note 1.

17 McLucas & Martens, *supra* note 9 ("Democratic self-governance requires that the governed be generally convinced of the system's evenhandedness. We are concerned that the SEC is damaging the perceived legitimacy of how the agency uses its enforcement power."); see also Peter J. Henning, *New Criticism over the S.E.C.'s Use of In-House Judges*, N.Y. TIMES (July 20, 2015), www.nytimes.com/2015/07/21/business/dealbook/new-criticism-over-the-secs-use-of-in-house-judges.html?_r=0 ("The notion that the S.E.C. has gathered all the relevant information, and that a defendant cannot question witnesses in advance of a trial, goes against the view that the [sic] each side should have the same opportunity to put on its case.").

18 See Eaglesham, *supra* note 1 ("Ms. McEwen [a former SEC judge] said the SEC in-house judges were expected to work on the assumption that 'the burden was on the people who were accused to show that they didn't do what the agency said they did.'"); McLucas & Martens, *supra* note 9 ("Whatever the complaints about the administrative process, there is no evidence that the ALJs harbor bias. The commission, by contrast, is the same body that brought the charges against the respondent."); Daniel R. Walfish, *The Real Problem with SEC Administrative Proceedings, and How to Fix It*, FORBES (July 20, 2015), <http://www.forbes.com/sites/danielfisher/2015/07/20/the-real-problem-with-sec-administrative-proceedings-and-how-to-fix-it/> ("My own observations are that the ALJs strive to be fair to all parties . . ."); cf. Eaglesham, *Overhaul*, *supra* note 16 ("Robert Mahony, who retired as an SEC

Antonin Scalia, have also echoed these concerns that ALJs are “in effect creat[ing] (and uncreat[ing]) new crimes at will.”¹⁹

As criticism continues to mount against the expanded use of internal administrative actions, the SEC has drastically decreased its use of administrative proceedings.²⁰ One reason for this could be the recent decision in *Hill v. SEC*, where the Federal District Court in the Northern District of Georgia ruled that Hill, the defendant, “ha[d] proved a substantial likelihood of success on the merits of his claim that the SEC ha[d] violated the Appointments Clause . . . [and] the Court f[ound] a preliminary injunction [was] appropriate to enjoin the SEC administrative proceeding.”²¹ Another reason for the decrease in the SEC’s use of administrative proceedings could be the U.S. Chamber of Commerce’s recent recommendations on how to improve the SEC’s Rules of Practice.²² Regardless of the reason, the SEC recently proposed amendments to its rules of procedure,²³ in an attempt “to modernize [its] rules.”²⁴ The proposed amendments, however, are still inadequate.²⁵ Additionally, the fact that the SEC is bringing fewer cases in administrative proceedings does not mean it will not increase the number of cases brought in the future. This is especially relevant if the Court of Appeals holds that

judge in 2012 after more than 14 years at the agency, told the New York conference the SEC judges were ‘absolutely 100% fair [and] straight.’” (alteration in original)).

19 *Whitman v. United States*, 135 S. Ct. 352, 353 (2014) (Scalia, J., respecting the denial of certiorari); *see also* Rakoff, *supra* note 2, at 11 (“[U]nder Dodd-Frank, [federal securities laws] could increasingly be construed and interpreted by the S.E.C.’s administrative law judges if the S.E.C. chose to bring its more significant cases in that forum.”).

20 *See* Eaglesham, *SEC Trims*, *supra* note 16 (“A review of 160 cases affecting more than 500 defendants shows that in the three months through September, the SEC sent just 11%—four of 36—of its contested cases to its administrative law judges. That was down from 40% in the like period of 2014.”).

21 *Hill v. SEC*, No. 1:5-CV-01801-LMM, 2015 WL 4307088, at *20 (N.D. Ga. June 8, 2015). Note that the SEC is currently appealing this decision to the Eleventh Circuit. *See* Brief for the Appellant at 15–21, *Hill v. SEC*, No. 15-12831 (11th Cir. Sept. 8, 2015).

22 *See generally* CTR. FOR CAPITAL MKTS., U.S. CHAMBER OF COMMERCE COMPETITIVENESS, EXAMINING U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT (2015) [hereinafter CHAMBER OF COMMERCE, RECOMMENDATIONS]; *infra* notes 84–110 and accompanying text.

23 U.S. SEC. & EXCH. COMM’N, AMENDMENTS TO THE COMMISSION’S RULES OF PRACTICE (2015) [hereinafter SEC, AMENDMENTS]; *cf.* Peter J. Henning, *A Small Step in Changing S.E.C. Administrative Proceedings*, N.Y. TIMES (Sept. 28, 2015), <http://www.nytimes.com/2015/09/29/business/dealbook/a-small-step-in-changing-sec-administrative-proceedings.html> (“[T]he S.E.C. did not acknowledge that the proposed changes were in any way related to criticism that its use of administrative proceedings gave the impression it was seeking a ‘home court advantage’ through truncated procedures to help get the outcome it wanted.”).

24 Press Release, U.S. Sec. & Exch. Comm’n, SEC Proposes to Amend Rules Governing Administrative Proceedings (Sept. 24, 2015), <http://www.sec.gov/news/pressrelease/2015-209.html> [hereinafter SEC, Press Release on Amendments].

25 *See infra* Section IV.C.

Hill does not have subject-matter jurisdiction to bring a case in federal court, similar to *Bebo v. SEC*.²⁶

This Note analyzes and explains the current issues and criticism regarding the SEC's use of ALJs. In particular, this Note recommends that the SEC ratify its ALJs in accordance with constitutional requirements, create a rigid formula for its forum selection, and amend its Rules of Practice to align more closely to the procedural due process rights in federal district courts. As many of these topics are currently being discussed in federal courts of appeals and within the SEC—through its proposed amendments to the Rules of Practice—this Note intends to add to the discussion on a topic with very little scholarly research. In the SEC's defense, the SEC's mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation"²⁷ is a necessary and important mission. Regardless of the mission, individuals are still guaranteed constitutional rights to procedural due process of law when there is a possibility of being "deprived of life, liberty or *property*."²⁸ The first Part of this Note will discuss the historical expansion of the SEC's enforcement powers. Part II will discuss the current enforcement procedures and the SEC's recently proposed amendments to its Rules of Practice. Part III will discuss the recent constitutional challenges that defendants have brought against the SEC and the issues regarding subject-matter jurisdiction in federal district courts. Part IV will propose three recommendations that the SEC should follow to avoid future criticism of its administrative proceedings.

I. HISTORY OF THE SEC'S ENFORCEMENT POWER AND PROCEDURES

Following the collapse of the United States economy during the Great Depression, Congress enacted the Federal Securities Act of 1933²⁹ in order to protect investors and "prohibit deceit, misrepresentations, and other fraud in the sale of securities."³⁰ In the following year, Congress passed the Securities Exchange Act of 1934.³¹ Since the inception of the SEC, it has struggled to "balance competing interests,"³² arising from the three objectives man-

26 *Bebo v. SEC*, 799 F.3d 765, 775 (7th Cir. 2015) ("We see no evidence . . . that Congress intended for plaintiffs like Bebo who are already subject to ongoing administrative enforcement proceedings to be able to stop those proceedings by challenging the constitutionality of the enabling legislation or the structural authority of the SEC.").

27 *What We Do*, U.S. SEC. & EXCH. COMM'N (last visited Mar. 22, 2016), <http://www.sec.gov/about/whatwedo.shtml>.

28 U.S. CONST. amend. V (emphasis added).

29 See generally Securities Act of 1933, Pub. L. 112-106, 48 Stat. 74.

30 *Fast Answers: The Laws that Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/about/laws.shtml> (last visited Mar. 22, 2016).

31 See generally Securities Exchange Act of 1934, Pub. L. 112-158, 48 Stat. 881.

32 Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 *FORDHAM J. CORP. & FIN. L.* 367, 368 (2008); see, e.g., *id.* ("As the SEC and its regulatory powers have grown in response to the ever more complex and international financial services markets, the seemingly straightforward mission of investor protection has become more intricate and multidimensional,

dated to the SEC: “to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.”³³ Therefore, it is important to give a quick summary of the history of the SEC.

A. *The Modest Expansion of Enforcement Power During
the First Fifty Years of Existence*

Although the SEC was created through the Securities Exchange Act,³⁴ the Enforcement Division of the SEC was not created until 1972.³⁵ Up until this point, “the Regional Offices conducted ‘[n]early all of the investigations,’ . . . while the Commission’s Trading and Exchanges Division played a largely supervisory and coordinating role.”³⁶ Additionally, “its enforcement powers were largely limited to seeking injunctions in federal district courts to enjoin violations of the securities laws, and the only express provision for administrative hearings was to suspend or expel members or officers of national securities exchanges.”³⁷

During the 1960s, with the adoption of new rules, the SEC’s “enforcement program grew to become ‘the life and breath of the Commission[,] . . . the guts of the agency.’”³⁸ To bring about this change, William J. Casey, then-Chairman of the SEC, restructured the organization to include “one division devoted entirely to enforcement.”³⁹ Additionally, in 1972, Chairman Casey formed “an advisory committee to ‘review and evaluate the Commission’s enforcement policies and practices and to make such recommendations as they deemed appropriate.’”⁴⁰ Later, this committee was termed the Wells Commission and provided many recommendations to protect defendants against an SEC enforcement proceeding.⁴¹ In particular, the Wells

prompting questions such as, ‘Who are the investors that should be protected?’ and ‘How should they be protected?’”).

33 See *What We Do*, *supra* note 27.

34 See generally Securities Exchange Act of 1934 § 4.

35 See DANIEL M. HAWKE, A BRIEF HISTORY OF THE SEC’S ENFORCEMENT PROGRAM 1934–1981, at 2–3 (2002), http://www.lexis securitiesmosaic.com/gateway/sec/speech/2000_2002_0101_SECHS_RT_Enfrmnt_Hawke.PDF.

36 *Id.* at 2 (quoting U.S. SEC. & EXCH. COMM’N, SIXTH ANNUAL REPORT 182 (1940)).

37 Rakoff, *supra* note 2, at 3.

38 HAWKE, *supra* note 35, at 3 (quoting U.S. SEC. & EXCH. COMM’N, “. . . GOOD PEOPLE, IMPORTANT PROBLEMS AND WORKABLE LAWS”: 50 YEARS OF THE U.S. SECURITIES AND EXCHANGE COMMISSION 46 (1984)).

39 *Id.*

40 Atkins & Bondi, *supra* note 32, at 375 (quoting JOHN A. WELLS ET AL., SEC REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES (JUNE 1, 1972), in ARTHUR F. MATHEWS ET AL., ENFORCEMENT AND LITIGATION UNDER THE FEDERAL SECURITIES LAWS 1973, at 275, 285 (1973)).

41 *Id.* at 376–77; see, e.g., U.S. SEC. & EXCH. COMM’N, PROCEDURES RELATING TO THE COMMENCEMENT OF ENFORCEMENT PROCEEDINGS AND TERMINATION OF STAFF INVESTIGATIONS 1 (1972) (“The Report of the Advisory Committee on Enforcement Policies and Practices [the Wells Report] . . . contained several recommendations designed to afford persons under investigation by the Commission an opportunity to present their positions to the Commission prior to the authorization of an enforcement proceeding.” (citing U.S. SEC. &

Commission wanted to ensure that the defendants maintained their right to due process, “a hallmark of our Anglo-American judicial system.”⁴² It is important to note that with all of the expansions of powers from 1934 until 1972, “the expansion was tied to the agency’s oversight of regulated entities or those representing those entities before the Commission” and any “broader remedies and sanctions it could [only obtain] by going to federal court.”⁴³

B. The Post-Insider Trading Sanctions Act of 1984 Expansions of Powers

The second Chairman of the SEC defended the powers of the administrative proceedings by stating the reason for these powers “is that no practical alternative exists in our complex society.”⁴⁴ When the SEC had limited powers, this was true; however, the Insider Trading Sanctions Act of 1984 provided the SEC, at its own request, “the power to order prospective compliance through injunctions.”⁴⁵ Although at the time this ancillary power only applied to “regulated persons and entities and only for certain violations of the securities laws,”⁴⁶ the SEC in effect received similar powers through administrative proceedings as it would have had in federal courts.⁴⁷

Further, during the 1980s, the SEC switched from primarily having a remedial and deterrent purpose—through injunctive and disgorgement remedies—to being “punitive in nature.”⁴⁸ Historically, the “power to seek ‘penalties’ in the form of prison sentences, criminal fines and restitution resided solely in the Department of Justice (‘DOJ’) and state authorities.”⁴⁹ Then, in 1984, the Insider Trading Act, provided treble damages for the SEC to use in insider-trading cases.⁵⁰ Additionally, when combining the additional enforcement remedies provided by the Insider Trading Act,⁵¹ the Insider

EXCH. COMM’N, REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES 31 (JUNE 1, 1972)).

42 Atkins & Bondi, *supra* note 32, at 383.

43 Rakoff, *supra* note 2, at 3.

44 *Id.* at 12.

45 *Id.* at 4.

46 *Id.*

47 *Id.*

48 Atkins & Bondi, *supra* note 32, at 383–84. For example, in a 1984 congressional report, the SEC sent a report to Congress stating that “[t]he federal securities laws are presently viewed by the courts as remedial rather than punitive.” *Id.* (quoting Memorandum from John S.R. Shad, Chairman, U.S. Sec. & Exch. Comm’n to Rep. Timothy E. Wirth, Chairman, Subcomm. on Telecomms., Consumer Prot. & Fin. of the H. Energy & Commerce Comm. 350 (Feb. 22, 1984)). However, by 1989, the SEC stated that “variable-penalty provisions are appropriate to *penalize and deter* the broad range of conduct for which these penalties will be assessed.” *Id.* at 384 (quoting *Hearing on H.R. 975 Before the Subcomm. On Telecomms. & Fin. Of the H. Comm. on Energy & Commerce*, 101st Cong. 36 (1989) (statement of David S. Ruder, Chairman, U.S. Sec. & Exch. Comm’n)).

49 Atkins & Bondi, *supra* note 32, at 386.

50 *Id.* at 387.

51 Insider Trading Sanctions Act of 1984, Pub. L. No. 98–376, 98 Stat. 1264.

Trading and Securities Fraud Enforcement Act of 1988,⁵² and the Securities Enforcement Remedies and Penny Stock Reform Act of 1990.⁵³ Through these three statutes, the SEC gained the power to “seek civil monetary penalties,” “to bar directors and officers . . . from serving in those capacities,” and “to issue administrative cease-and-desist orders, temporary restraining orders, and orders for disgorgement.”⁵⁴

Although the SEC could now bring cases involving defendants not regulated by the SEC as administrative proceedings, the sanctions available were very limited and did not include civil monetary penalties.⁵⁵ The ability to impose monetary penalties and more severe penalties in administrative proceedings still only applied to persons or entities *regulated* by the SEC.⁵⁶ In addition, the ability to bring monetary civil penalties in administrative proceedings, was still rare until after the Sarbanes-Oxley Act of 2002.⁵⁷

C. *The Expansion of Civil Monetary Penalties Post-Sarbanes-Oxley Act of 2002*

Following the Enron and WorldCom scandals in the early part of the 21st century, Congress passed the Sarbanes-Oxley Act of 2002 (SOX).⁵⁸ SOX further expanded the SEC’s enforcement powers by granting the SEC “the power to employ administrative proceedings to bar any person who had violated the securities laws from serving as an officer or director of a public company.”⁵⁹ It also increased the ability of the SEC to impose monetary civil penalties for violations of the securities laws in administrative proceedings—against regulated persons or entities—and imposed “significant, additional requirements on corporations and their officers and directors.”⁶⁰

Just as important as the changes SOX brought about was the change in policy at the SEC.⁶¹ Following the Penny Stock Reform Act, Congress expected the SEC to use its punitive powers “*only* when a violation resulted in improper benefits to shareholders”⁶² and federal courts to keep this power in

52 Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677.

53 Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931.

54 Atkins & Bondi, *supra* note 32, at 385.

55 CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 11–12.

56 *Id.*; *see also* Rakoff, *supra* note 2, at 3, 5.

57 *See* Sonia A. Steinway, Comment, *SEC “Monetary Penalties Speak Very Loudly,” but What Do They Say? A Critical Analysis of the SEC’s New Enforcement Approach*, 124 *YALE L.J.* 209, 211 fig.1 (2014); *see also* Atkins & Bondi, *supra* note 32, at 394 (“After the Remedies Act was signed into law in 1990 and before the SEC’s April 2002 Xerox case, the Commission brought only four issuer-penalty cases, totaling less than \$5 million.”).

58 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

59 Rakoff, *supra* note 2, at 5.

60 Atkins & Bondi, *supra* note 32, at 395.

61 *Id.* at 394 (“The Xerox case, in which the company paid a \$10 million penalty, is viewed by many as the beginning of the ‘corporate penalty era’ at the Commission.”).

62 *Id.* at 393.

check.⁶³ Following SOX, the SEC sought civil monetary damages in many more cases than before.⁶⁴ Additionally, the civil monetary damages sought were much larger⁶⁵ and possibly targeted primarily at larger corporations.⁶⁶ In conclusion, SOX greatly expanded the SEC's enforcement powers and set the stage for the Dodd-Frank Act, which would expand the SEC's enforcement powers even further, especially in regards to the types of cases brought in administrative proceedings.

II. CURRENT SEC ENFORCEMENT PROCEDURES AND RECENT PROPOSED AMENDMENTS

This Part will look at the changes to the SEC's enforcement practices following the Dodd-Frank Act. The changes in enforcement practices and expansion of power have many legal experts recommending procedural changes to bring the SEC into compliance with constitutional due process requirements.⁶⁷ In particular, the United States Chamber of Commerce recently released a report examining the SEC's enforcement division and presenting twenty-eight separate recommendations—addressing issues with the SEC's current Rules of Practice.⁶⁸ Shortly after the Chamber of Commerce's report, the SEC proposed amendments to its enforcement practices,⁶⁹ following some but not all of the Chamber of Commerce's recommendations.⁷⁰ Therefore, following the discussion on the changes in enforcement practices and expansion of enforcement powers, this Part will discuss the recommendations presented by the Chamber of Commerce and the SEC's recently proposed amendments to “modernize” its enforcement practices.⁷¹

63 *Id.* (“Congress took comfort in the fact that federal judges would operate as an independent check to the Commission’s decision to seek an issuer penalty and the amount sought to be recovered.”).

64 *Id.* at 400 (“The total amount of issuer penalties in 2003 and 2004 was greater than the total amount of *all* penalties imposed by the SEC for the prior fifteen years combined. From 2003 through 2007, approximately \$13.8 billion in disgorgement and civil penalties were ordered to be paid to the SEC, courts, or other appointed trustees.”).

65 *See* Steinway, *supra* note 57, at 210 (“Since 2000, the growth has been even more striking: penalties have grown 30% year-over-year, compared to 3% growth in cases filed.”).

66 James D. Cox et al., *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 NOTRE DAME L. REV. 893, 902 (2005) (finding that the “[a]verage market capitalization for SEC enforcement targets was more than twenty-three times bigger in the post-January 1, 2002, time period than in the earlier period, while the median market capitalization went up by a multiple of over thirteen times”).

67 *See supra* notes 9–12 and accompanying text.

68 CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22.

69 *See generally* SEC, AMENDMENTS, *supra* note 23.

70 *See infra* Section IV.C.

71 SEC, Press Release on Amendments, *supra* note 24.

A. *Expansion of Enforcement Powers Following the Dodd-Frank Wall Street Reform and Consumer Protection Act*

Following the financial crisis of 2008, Congress enacted the Dodd-Frank Act, with the goal

[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end “too big to fail,” to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.⁷²

The Dodd-Frank Act, however, also significantly expanded the SEC’s administrative enforcement power to levels never seen before in the SEC.⁷³ The problem with this expansion is that “the S.E.C. can today obtain through internal administrative proceedings nearly everything it might obtain by going to court.”⁷⁴ Not only is this concerning because it is exactly what many in Congress and internally within the SEC did not want to happen when expanding the SEC’s power during the 1980s,⁷⁵ but it also deprives defendants of many procedural rights which are guaranteed under due process of law if brought in federal district court.⁷⁶

The main expansion of the SEC’s enforcement power comes from Section 929P(a) of the Dodd-Frank Act, which allows the SEC to impose civil monetary penalties in an administrative proceeding upon any person who has violated the federal securities laws.⁷⁷ This is new because in the past, the SEC could only impose civil monetary penalties through administrative proceedings on persons or entities regulated by the SEC,⁷⁸ not simply any person. The SEC and Congress defended its new expansion of enforcement power by stating that Section 929P(a) “streamlines the SEC’s existing enforcement authorities by permitting the SEC to seek civil money penalties

72 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010); see SEC, Press Release on Amendments, *supra* note 24.

73 See Rakoff, *supra* note 2, at 5.

74 *Id.*; see also CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 12.

75 See Atkins & Bondi, *supra* note 32, at 393–94 (“The concern among members of Congress and internally at the SEC was that if the same remedies were available to the SEC under both judicial and administrative proceedings, then the SEC might be perceived to have an incentive to conduct more enforcement actions through its own administrative proceedings, rather than before a federal district court judge.”).

76 See Rakoff, *supra* note 2, at 6–7 (discussing the differences between an SEC administrative proceeding and a federal district court proceeding and noting that “[i]t is hardly surprising in these circumstances that the S.E.C. won 100% of its internal administrative hearings in . . . 2014, whereas it won only 61% of its trials in federal court during the same period”); see also *infra* notes 162–207 and accompanying text.

77 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 929P(a), 124 Stat. 1862; see also Rakoff, *supra* note 2, at 5 (“Section 929P(a) gives the S.E.C. the power through internal administrative proceedings to impose substantial monetary penalties against any person or entity whatsoever . . .”).

78 See, e.g., Rakoff, *supra* note 2, at 2 (quoting Andrew Ceresney, Director of the Division of Enforcement of the SEC, as saying, “Our expectation is that we will be bringing more administrative proceedings given the recent statutory changes.”).

in cease-and-desist proceedings under Federal securities laws.”⁷⁹ Section 211 continues by stating that the new streamlined enforcement power allows due process because it is “coextensive with its authority to seek penalties in Federal court, and because, similar to a proceeding in federal district court, the defendant can appeal the penalty to a federal appeals court.”⁸⁰ In contrast to the SEC’s reasoning, *Chevron* deference prevents the defendants from receiving a proper appellate procedure.⁸¹ Additionally, the SEC can now bring complicated insider-trading cases in an administrative proceeding,⁸² which deprives defendants of their constitutional right to procedural due process.⁸³

B. The U.S. Chamber of Commerce’s Criticism of SEC Enforcement Practices and the SEC’s Proposed Amendments to the SEC’s Rules of Practice

In July of 2015, the United States Chamber of Commerce released a lengthy report that examined the SEC’s enforcement division and practices and also issued twenty-eight separate recommendations on how to improve the SEC’s current enforcement practices.⁸⁴ The recommendations were broken down into three main categories: recommendations on SEC enforcement policies, recommendations on commission oversight of the enforcement program, and recommendations to improve the efficiency and effectiveness of the SEC investigative process.⁸⁵ All three categories are important for the SEC to examine when implementing new policies. For the purposes of this Note, the focus will be more on the first category—recommendations on SEC enforcement policies. In particular, the first four recommendations on “providing a structure for the choice of forum decision that incorporates due process protection” are directly related to the due process issues defendants are bringing in federal district and appellate courts.⁸⁶

It is important to note that the Chamber of Commerce did not submit these recommendations with the intent to hinder the enforcement efforts of the SEC.⁸⁷ Instead, these recommendations—in particular the first four recommendations—are intended to ensure a “tough-as-nails, vigorous, effective

79 COMM. ON FIN. SERVICES, H.R. REP. NO. 111-687, § 211, at 78 (2009), <https://www.congress.gov/111/crpt/hrpt687/CRPT-111hrpt687-pt1.pdf>.

80 *Id.*

81 *See infra* note 229 and accompanying text.

82 *See, e.g.*, CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 12 (“Section 925 of the Dodd-Frank Act . . . further expanded the Commission’s sanctioning power It also provided the authority to impose money penalties against persons or entities not registered with the Commission.”).

83 *See infra* Section III.C.

84 *See generally* CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22.

85 *See id.* at 1.

86 *See id.* at 3 (stating that the differences between administrative proceedings and federal district court “can have a significant impact on the procedural rights of a defendant/respondent and, ultimately, on the respondent’s ability to obtain a full, *fair*, and impartial adjudication” (emphasis added)).

87 *Id.* at 2.

enforcement coupled with a *clear and fair process*.⁸⁸ The first three recommendations directly address the issue Judge Rakoff presented in his address at the PLI Securities Regulation Institute's 2014 conference. Judge Rakoff was concerned that through the use of its ALJs, the SEC was in effect creating new law.⁸⁹ The first recommendation directly addresses this issue by implementing a clear process for the SEC to utilize when determining whether the case should be brought as an administrative proceeding or before a federal district court.⁹⁰ The second recommendation helps to remove any remaining ambiguity in the SEC's selection of forum by allowing defendants to "challenge the choice of forum" selected by the SEC.⁹¹ The third recommendation is slightly more drastic than the first two. It states, "The Commission should adopt a policy that *any party* named in an administrative proceeding that desires a jury trial may file a notice to remove the proceeding to federal district court."⁹² The fourth recommendation also addresses many due process issues, by recommending the SEC revise its current enforcement practices concerning pre-trial discovery and length of the pre-hearing process.⁹³

On May 8, 2015, the SEC's enforcement division released a guideline on how to decide whether to bring a case in an administrative proceeding or in federal district court.⁹⁴ Although there is no indication that the SEC was responding to recent criticism in its report, the timing suggests that the SEC was in fact responding to recent criticism, which even came from within the SEC itself.⁹⁵ The approach to forum selection identifies four key factors that should be considered.⁹⁶ First, the enforcement division said that it will con-

88 *Id.* at 9 (emphasis added).

89 See Rakoff, *supra* note 2, at 12 (concluding his address by saying, "I would urge the S.E.C. to consider that it is neither in its own long-term interest, nor in the interest of the securities markets, nor in the interest of the public as a whole, for the S.E.C. to become, in effect, a law unto itself.").

90 See CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 3 (stating that the SEC should only use administrative proceedings if "[t]he proceeding is based upon well-established legal principles that have been adopted by Article III courts" and other factors listed in the recommendation); see also *infra* Section IV.B.

91 See CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 4.

92 See *id.* (emphasis added).

93 *Id.*; see *infra* Section IV.C (discussing the differences between federal district court procedures and administrative proceedings).

94 U.S. SEC. & EXCH. COMM'N, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS (2015), <https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf> [hereinafter SEC, FORUM SELECTION].

95 See Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly and Efficient SEC (Feb. 20, 2015), <http://www.sec.gov/news/speech/022015-spchcmsp.html> ("To avoid the perception that the Commission is taking its tougher cases to its in-house judges, and to ensure that all are treated fairly and equally, the Commission should set out and implement guidelines for determining which cases are brought in administrative proceedings and which in federal courts.").

96 See SEC FORUM SELECTION, *supra* note 94, at 1-3.

sider “[t]he availability of the desired claims, legal theories, and forms of relief in each forum.”⁹⁷ Second, it will consider “[w]hether any charged party is a registered entity or an individual associated with a registered entity.”⁹⁸ Third, it will consider “[t]he cost-, resource-, and time-effectiveness of litigation in each forum.”⁹⁹ Fourth, it will take into account “[f]air, consistent, and effective resolution of securities law issues and matters.”¹⁰⁰ It is also made very clear in the guidelines that these four factors are not dispositive and each case will be looked at on a case-by-case basis.¹⁰¹ Therefore, although it appears that the SEC has already addressed the U.S. Chamber of Commerce’s first recommendation, it has also been made explicitly clear that the SEC retains its right to bring cease-and-desist proceedings before an ALJ, at its own discretion.¹⁰²

More recently, on September 24, 2015, the SEC released a list of amendments that would update its Rules of Practice.¹⁰³ The proposed amendments are primarily related to the fourth recommendation proposed by the Chamber of Commerce’s report, which called for revisions to the Rules of Practice “to provide adequate opportunities for pre-trial discovery and depositions.”¹⁰⁴ The key parts of the amendments seek “to adjust the timing of hearings and other deadlines in administrative proceedings and to provide parties in administrative proceedings with the ability to use depositions and other discovery tools.”¹⁰⁵ Although the SEC mentions multiple times in its proposed amendments that the “proposed amendments . . . would outline procedures for deposition practice that are consistent with the Federal Rules of Civil Procedure,”¹⁰⁶ there are still many places where the proposed amendments fall short of the protections provided in federal district

97 *Id.* at 1.

98 *Id.* at 2.

99 *Id.*

100 *Id.* at 3.

101 *Id.* at 1 (“While the list of potentially relevant considerations set out below is not (and could not be) exhaustive, the Division may in its discretion consider any or all of the factors in assessing whether to recommend that a contested case be brought in the administrative forum or in federal district court.”).

102 *Id.* (“The Commission generally is authorized to bring its enforcement actions in either of two forums—a civil action in federal district court or a Commission administrative proceeding (and/or cease-and-desist proceeding) before an [ALJ]”); *see also* Nicolas Bourtin et al., *Sullivan & Cromwell Discusses SEC Guidance on Approach to Forum Selection in Contested Actions*, CLS BLUE SKY BLOG (June 15, 2015), <http://clsbluesky.law.columbia.edu/2015/06/15/sullivan-cromwell-discusses-sec-guidance-on-approach-to-forum-selection-in-contested-actions/> (“It is also noteworthy that the SEC continues to assert its right—and even suggests a preference—to pursue novel securities law questions in administrative proceedings rather than in federal court actions.”).

103 *See generally* SEC, AMENDMENTS, *supra* note 23, at 1.

104 *See* CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 4.

105 SEC, AMENDMENTS, *supra* note 23, at 1.

106 *Id.* at 8; *see also id.* at 13 (discussing how the proposed amendments would make the SEC’s Rules of Practice similar to the Federal Rules of Civil Procedure when expert witnesses submit information for an administrative proceeding); *id.* at 14 (proposing to

courts¹⁰⁷—for example, SEC rules on hearsay,¹⁰⁸ depositions,¹⁰⁹ and length of time for defendants to conduct discovery.¹¹⁰

III. RECENT CHALLENGES BROUGHT AGAINST THE SEC AND WHY DISTRICT COURTS ARE HESITANT TO HEAR THEM

On March 1, 2011, the SEC instituted an internal cease-and-desist proceeding against its first non-regulated person, Rajat K. Gupta, in an administrative proceeding.¹¹¹ Gupta and twenty-eight other similarly situated defendants from Galleon—some of whom were regulated by the SEC—were charged with insider trading.¹¹² Gupta, however, was the only defendant whose case was brought within the SEC rather than in federal district court.¹¹³ Gupta challenged this “seeming exercise in forum-shopping” on the grounds that he was being denied his right to equal protection of the law.¹¹⁴ He also argued that the Dodd-Frank Act was being applied retroactively to his case, considering his alleged actions occurred before the Dodd-Frank Act was passed. It was undisputed that before the act was passed, “the SEC had *no* power to impose such penalties in an administrative action against a non-regulated person.”¹¹⁵ The SEC moved to dismiss the case on

extend the methods of service to be similar to the methods provided in the Federal Rules of Civil Procedure).

107 See *infra* Section IV.C.

108 Compare SEC, AMENDMENTS, *supra* note 23, at 16–17 (stating that hearsay is in fact admissible in administrative proceedings), with FED. R. EVID. 802 (“Hearsay is not admissible . . .”).

109 Compare SEC, AMENDMENTS, *supra* note 23, at 7 (allowing defendants to “file notices to depose three persons”), with FED. R. CIV. P. 31(a)(1)–(2) (allowing up to 10 depositions without leave, and even more with leave). Additionally, the U.S. Chamber of Commerce stated in their recommendations that “changes should be made to the Commission’s rules governing administrative proceedings to . . . balance out the staff’s use of subpoenas and depositions during the investigation stage,” CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 18, because although the SEC is limited to three notices in a proceeding, they are not limited in the number of subpoenas “to provide documents and testimony under oath,” U.S. SEC. & EXCH. COMM’N, ENFORCEMENT DIVISION, ENFORCEMENT MANUAL 17 (2015).

110 Compare SEC, AMENDMENTS, *supra* note 23, at 5 (“The amended rule would provide that the hearing must be scheduled to begin approximately four months after service of the order instituting proceedings, but not later than eight months after service of the order.”), with Henning, *supra* note 23 (“Even with these amendments, the time in which an administrative case would be completed is still fairly short, about one year. Federal court actions usually take two to three times as long because of the broader discovery rights . . .”).

111 *Gupta v. SEC*, 796 F. Supp. 2d 503, 506 (S.D.N.Y. 2011).

112 *Id.* at 506.

113 *Id.*; see also CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 13 (stating that Gupta, who was not directly regulated by the SEC, was the only Galleon-related defendant whose case was brought as an administrative proceeding).

114 *Gupta*, 796 F. Supp. 2d at 506.

115 *Id.* at 507.

the grounds that a federal district court did not have jurisdiction over this case and that Gupta “must exhaust administrative remedies before seeking redress in federal court.”¹¹⁶ The U.S. District Court for the Southern District of New York dismissed this motion.¹¹⁷ The court cited *Free Enterprise Fund v. Public Co. Accounting Oversight Board* and *Touche Ross & Co. v. SEC*,¹¹⁸ along with other cases and statutes to determine that it does in fact have jurisdiction, when it appears that a defendant was denied his or her equal protection of the law.¹¹⁹ Before the case was decided on its merits, however, the SEC agreed with Gupta to bring the claim in district court, leaving the issues of standing and the other constitutional due process concerns brought by Gupta unheard by the federal courts.¹²⁰

Therefore, when the SEC began bringing more complicated insider-trading cases through administrative proceedings towards the end of 2013, many of the defendants decided to challenge the SEC’s forum selection in federal district court.¹²¹ The following subparts will analyze the arguments made by defendants, including: that ALJs are in fact inferior officers and subject to the Appointments Clause of the United States Constitution, and that defendants in administrative proceedings are denied their constitutional right to procedural due process, including right to a jury trial and equal protection of the law. But first, the following subpart will discuss whether a defendant in an administrative proceeding has standing in federal district court before his or her case can be heard before an ALJ.

A. *Jurisdiction: Three-Factor Test Presented in Free Enterprise Fund*

The United States federal district courts “have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.”¹²² When challenging the constitutionality of administrative proceedings, “it is established practice . . . to sustain the jurisdiction of federal courts to issue injunctions to protect rights safeguarded by the Constitution.”¹²³ In order to obtain a preliminary injunction, which is what the defendants have sought in federal district courts against the SEC, the defendant must prove three elements: “(1) [H]e is likely to succeed on the merits of the underlying

116 *Id.* at 508–10.

117 *Id.* at 514.

118 *See id.* at 512–13 (citing *Free Enter. Fund v. PCAOB*, 130 S. Ct. 3138, 3150 (2010); *Touche Ross & Co. v. SEC*, 609 F.2d 570 (2d Cir. 1979)).

119 *Id.* at 513–14.

120 *See* CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 13.

121 *See generally* *Tilton v. SEC*, No. 15-CV-2472, 2015 WL 4006165 (S.D.N.Y. June 30, 2015); *Hill v. SEC*, No. 1:150CV-01801, 2015 WL 4307088 (N.D. Ga. June 8, 2015); *Duka v. SEC (Duka I)*, No. 15 Civ. 357, 2015 WL 1943245 (S.D.N.Y. Apr. 15, 2015); *Bebo v. SEC*, No. 15-C-3, 2015 WL 905349 (E.D. Wis. Mar. 3, 2015); *Chau v. SEC*, 72 F.Supp.3d 417 (S.D.N.Y. 2014).

122 28 U.S.C. § 1331 (2012).

123 *Free Enter. Fund*, 130 S. Ct. at 3151 n.2 (2010) (alteration in original) (quoting *Bell v. Hood*, 327 U.S. 678, 684 (1946)).

claim, (2) he will suffer irreparable harm absent injunctive relief, and (3) the public interest weighs in favor of granting the injunction.”¹²⁴ The SEC argues that even if the elements of a temporary injunction are present, the federal district courts do not have jurisdiction because Congress intended to restrict jurisdiction in these instances through the Dodd-Frank Act.¹²⁵ In *Free Enterprise Fund*, however, the Supreme Court outlined three factors that it considers when deciding if Congress “intend[ed] to limit jurisdiction.”¹²⁶ The first factor considered is whether “a finding of preclusion could foreclose all meaningful judicial review.”¹²⁷ The second factor is whether “the suit is ‘wholly collateral to a statute’s review provisions.’”¹²⁸ And the third factor is whether “the claims are ‘outside the agency’s expertise.’”¹²⁹

In cases such as *Bebo*—brought in the Eastern District of Wisconsin and appealed to the Seventh Circuit—the court held that it did not have subject matter jurisdiction to hear the case, which means that the court never decided the case on the merits.¹³⁰ The reasoning for this holding is that, “meaningful judicial review is available to *Bebo* . . . because she does not have to assume the risk of a sanction before testing the validity of the law. If the SEC renders an adverse final decision, judicial review awaits in the court of appeals.”¹³¹ In *Duka*, however, the Southern District of New York disagreed because “[t]he Court of Appeals obviously would not be able . . . to enjoin the SEC from conducting the Administrative Proceeding, as *Duka* asks this court to do.”¹³² Currently, *Bebo* seems to be the exception, and more courts are deciding that defendants have subject matter jurisdiction.¹³³

If courts find that the defendant in an SEC administrative proceeding lacks “meaningful judicial review,” it is generally agreed upon that the arguments made by defendants are “wholly collateral” because the defendants are not attacking an order resulting from the administrative proceedings.

124 *Pope v. Cty. of Albany*, 687 F.3d 565, 570 (2d Cir. 2012) (citing *Oneida Nation of N.Y. v. Cuomo*, 645 F.3d 154, 164 (2d Cir. 2011)).

125 *See Hill*, 2015 WL 4307088, at *5.

126 *See id.* (quoting *Free Enter. Fund*, 130 S. Ct. at 3150).

127 *Free Enter. Fund*, 130 S. Ct. at 3150 (quoting *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212–13 (1994)).

128 *Id.* (quoting *Thunder Basin Coal*, 510 U.S. at 212).

129 *Id.* (quoting *Thunder Basin Coal*, 510 U.S. at 212).

130 *See Bebo v. SEC*, 799 F.3d 765, 767 (7th Cir. Aug. 24, 2015); *see also Bebo v. SEC*, No. 15-C-3, 2015 WL 905349, at *4 (E.D. Wis. Mar. 3, 2015).

131 *Bebo*, 799 F.3d at 775.

132 *Duka I*, No. 15 Civ. 357, 2015 WL 1943245, at *5 (S.D.N.Y. Apr. 15, 2015).

133 *Compare Bebo*, 799 F.3d at 775 (holding that the court did not have subject matter jurisdiction), *with Duka v. SEC (Duka III)*, No. 15 Civ. 357, SEC 2015 WL 1943245, at *8 (S.D.N.Y. Sept. 17, 2015) (denying the SEC’s “motion to stay the . . . preliminary injunction pending appeal”); *Hill v. SEC*, No. 1:15-CV-01801-LLM, 2015 WL 4307088, at *20 (N.D. Ga. June 8, 2015) (finding “a preliminary injunction is appropriate to enjoin the SEC administrative proceeding and to allow the Court sufficient time to consider this matter on the merits”).

Rather, they are challenging the constitutionality of that proceeding.¹³⁴ Additionally, there is little to no dispute between district courts that ALJs lack the expertise and ability to hear constitutional challenges,¹³⁵ which is notable considering the SEC took it upon itself to find that the appointment of ALJs is in fact constitutional because they are “mere employees” rather than “inferior officers.”¹³⁶

When determining whether a defendant’s claim passes the test for a preliminary injunction, it is relatively easy to see how “irreparable harm” would occur to the defendant if the case went through an administrative proceeding and an ALJ ruled adversely on the defendant’s case.¹³⁷ Additionally, although the SEC claims that the efficiency and effectiveness of its administrative proceedings outweigh the defendant’s desire to have their case tried in a federal district court, the court in *Hill* held that “[t]he public has an interest in assuring that citizens are not subject to unconstitutional treatment by the Government, and there is no evidence the SEC would be prejudiced by a *brief delay*.”¹³⁸ Therefore, the next subpart will discuss whether the defendants’ arguments have merit to justify a preliminary injunction.

B. Appointment Clause Issues

Although defendants have challenged the SEC’s use of ALJs for many different reasons, the issue that has received the most attention by federal judges is the Appointments Clause issue.¹³⁹ According to Article II of the United States Constitution, “Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.”¹⁴⁰ The defendants’ argument has two parts. First, and most debated, is that ALJs are inferior officers of the United States and not employees as the SEC proposes.¹⁴¹ If the SEC is correct and ALJs are only employees, then they do not need to be appointed

134 *Duka III*, 2015 WL 1943245, at *12 (“The Court notes . . . that the issue being reviewed here is whether the Court has subject matter jurisdiction over Plaintiff’s constitutional claim for injunctive and declaratory relief. That is separate and apart from a federal court’s jurisdiction to review any orders which may be issued by the SEC in the Administrative Proceeding.”).

135 *Id.* at *14 (citing *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212–13 (1994)); *see also Hill*, 2015 WL 4307088, at *9 (N.D. Ga. June 8, 2015).

136 *In re Lucia Cos., Inc.*, No. 3-15006, at 28–29 (U.S. Sec. & Exch. Comm’n Sept. 3, 2015).

137 *Hill*, 2015 WL 4307088, at *19 (“Plaintiff will be irreparably harmed if this injunction does not issue because . . . Plaintiff will be subject to an unconstitutional administrative proceeding, and he would not be able to recover monetary damages for this harm because the SEC has sovereign immunity.” (citing *Odebrecht Const., Inc. v. Sec’y, Fla. Dep’t of Transp.*, 715 F.3d 1268, 1289 (11th Cir. 2013))).

138 *Id.* (emphasis added).

139 *See generally Hill*, 2015 WL 4307088, at *9–19; *Duka I*, No. 15 Civ. 357, 2015 WL 1943245, at *7–10 (S.D.N.Y. Apr. 15, 2015).

140 U.S. CONST. art. II, § 2.

141 *In re Lucia Cos., Inc.*, No. 3-15006, at 29.

in accordance with the United States Constitution.¹⁴² Second, if ALJs are in fact inferior officers, then they need to be “appointed by the President, department heads, or courts of law.”¹⁴³ The SEC concedes that ALJs were not appointed by the President, a court of law, or a department head¹⁴⁴—the Supreme Court found in *Free Enterprise Fund* that the “SEC Commissioners jointly constitute the ‘head’ of the SEC for appointment purposes.”¹⁴⁵ Therefore, the main issue is whether SEC ALJs are inferior officers of the United States or employees of the SEC.

When the Commissioners heard an appeal from an administrative proceeding regarding Raymond J. Lucia, Sr., the Commission held that its ALJs were employees and not inferior officers;¹⁴⁶ therefore, although ALJ Elliot “was not appointed in a manner consistent with the Appointments Clause of the Constitution,” the proceedings were valid and the Commission could uphold the resulting orders.¹⁴⁷ In making this decision, the Commissioners relied solely on the D.C. Circuit’s decision in *Landry v. FDIC*.¹⁴⁸ In *Landry*, the D.C. Circuit held that ALJs at the Federal Deposit Insurance Corporation (FDIC) were not inferior officers of the United States because they did not have power to issue a final decision.¹⁴⁹ In making this decision, the D.C. Circuit had to distinguish the Supreme Court’s decision in *Freytag v. Commissioner*.¹⁵⁰ *Freytag* held that special trial judges (STJs) in Tax Court are inferior officers, noting that “[t]he fact that an inferior officer on occasion performs duties that may be performed by an employee not subject to the Appointments Clause does not transform his status under the Constitution.”¹⁵¹ *Landry* highlights this last part, noting that the difference between an STJ and an ALJ is “that STJs have the authority to render a final decision of the tax court in declaratory judgment proceedings and in certain small-amount tax cases. . . . But the ALJs here can never render the decision of the

142 *Id.*

143 *Hill*, 2015 WL 4307088, at *19 (citing U.S. CONST. art. II, cl. 2).

144 *Duka v. SEC (Duka II)*, No. 15 Civ. 357, 2015 WL 4940057, at *2 (S.D.N.Y. Aug. 3, 2015).

145 *Hill*, 2015 WL 4307088, at *19 (quoting *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 511–12 (2010)).

146 *In re Lucia Cos., Inc.*, No. 3-15006, at 28–33.

147 *Id.*

148 *Id.*

149 See *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C. Cir. 2000). Interestingly enough, *Landry* still held that the D.C. Circuit had jurisdiction to hear the case—which is contrary to the SEC’s argument in federal district court. *Id.* at 1131 (“*Freytag* itself indicates that judicial review of an Appointments Clause claim will proceed even where any possible injury is radically attenuated.”).

150 *Id.* at 1134 (distinguishing *Landry* from *Freytag* because it believed “the STJs’ power of final decision in certain classes of cases was critical to the Court’s decision”).

151 *Freytag v. CIR*, 501 U.S. 868, 882 (1991).

FDIC.”¹⁵² Not surprisingly, the SEC bases its argument on *Landry*,¹⁵³ while the defendants rely on *Freytag*.¹⁵⁴

In *Freytag*, the Commissioner argued that the STJs were employees because “they lack authority to enter a final decision.”¹⁵⁵ The Supreme Court, however, rejected this argument, saying that it “ignores the significance of the duties and discretion that special trial judges possess.”¹⁵⁶ Instead, the court focused on the fact that STJs were “‘established by [l]aw,’ . . . and the duties, salary, and means of appointment for that office are specified by statute.”¹⁵⁷ Additionally, the Court focused on the fact that STJs “perform more than ministerial tasks.”¹⁵⁸ In Charles Hill’s supplemental brief, he argued that SEC ALJs perform similar if not the same tasks as the STJs in *Freytag*.¹⁵⁹ Additionally, he challenged the SEC’s argument that the SEC ALJs do not render a final decision, because if the Commission does not review a decision of the ALJ, then the ALJ’s decision is “deemed the action of the Commission.”¹⁶⁰

Following these comparisons to STJs, the defendants in SEC proceedings have a compelling argument that ALJs are in fact inferior officers based on the reasoning in *Freytag*—a Supreme Court decision—instead of the reasoning in *Landry*—a D.C. Circuit decision. To make their argument even more compelling, the defendants cite Justice Scalia’s concurring opinion—which was joined by Justices O’Connor, Kennedy, and Souter—in *Freytag*, where he explicitly stated ALJs “are all executive officers.”¹⁶¹ Therefore, it is not surprising that two different district courts halted four administrative proceedings because the federal district court judges believed the Appointments Clause challenge may have merit.¹⁶²

152 *Landry*, 204 F.3d at 1133 (citation omitted).

153 *In re Lucia Cos., Inc.*, No. 3-15006, at 28–33.

154 See *Bebo* Memorandum, *supra* note 13, at 37–38.

155 *Freytag*, 501 U.S. at 881.

156 *Id.*

157 *Id.* (internal citations omitted) (quoting U.S. CONST. art. II, § 2, cl. 2).

158 *Id.* at 881–82 (stating further that STJs “take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. . . . [T]he special trial judges exercise significant discretion.”).

159 *Hill* Supplemental Brief, *supra* note 14, at 7 (“[T]hat SEC ALJs are conferred with the authority to ‘[r]egulate the course of a hearing,’ 17 C.F.R. § 200.14, shows that, similar to their STJ counterparts, SEC ALJs exercise ‘significant discretion’ in ‘carrying out the[ir] important functions.” (citing *Freytag*, 501 U.S. at 882) (alterations in original)).

160 *Id.* at 7–8 n.6 (quoting 15 U.S.C. § 78d-1(c) (2012)).

161 *Id.* at 8 (quoting *Freytag*, 501 U.S. at 910 (Scalia, J., concurring in part and concurring in the judgment) (emphasis added)).

162 See generally *Gray Fin. Group, Inc. v. SEC*, No. 1:15-CV-0492 (N.D. Ga. Aug. 4, 2015); *Tilton v. SEC*, No. 15-CV-2472, 2015 WL 4006165 (S.D.N.Y. June 30, 2015); *Hill v. SEC*, No. 1:15-CV-01801, 2015 WL 4307088 (N.D. Ga. June 8, 2015); *Duka I*, No. 15 Civ. 357, 2015 WL 1943245 (S.D.N.Y. Apr. 15, 2015).

C. *Due Process, Equal Protection, and Right to a Jury Trial*

In *Gupta*, the Southern District of New York held that Gupta's claim that his equal protection rights were violated might have merit.¹⁶³ As previously mentioned, before the court was able to decide the matter, the SEC agreed to move his case to federal district court—as opposed to an administrative proceeding—if he agreed to drop his claim that his equal protection rights were violated.¹⁶⁴ More recently, defendants challenging the constitutionality of the SEC's use of administrative proceedings have continued to make similar procedural arguments that Gupta made in 2011.¹⁶⁵ The defendants asserted that the SEC's use of administrative proceedings violates their right to a jury trial under the Seventh Amendment.¹⁶⁶ The second argument the defendants asserted is that the Dodd-Frank Act deprives them of their Fifth Amendment right to equal protection of the laws by “grant[ing] the SEC unbridled authority to *arbitrarily* determine whether a citizen receives her jury trial right.”¹⁶⁷ The third and final procedural argument made by defendants is that the SEC's Rules of Practice deprive defendants of “property” without providing them with “procedural due process” of law in violation of the Fifth and Fourteenth Amendments.¹⁶⁸

The first argument stems from the Seventh Amendment of the United States Constitution, which states, “[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved.”¹⁶⁹ According to the Northern District of Georgia, the Seventh Amendment applies to “an enforcement action for civil penalties,” which “is ‘clearly analogous to the 18th-century action in debt.’”¹⁷⁰ The SEC agrees with this argument.¹⁷¹ Instead, the SEC argues—and the Northern District of Georgia agrees¹⁷²—that due to the Supreme Court's decision in *Atlas Roofing*, Congress has the ability to assign the adjudication in cases that involve “public rights”¹⁷³ where the case arose “between the Government and persons subject to its authority ‘in connection with the performance of the constitutional functions of the executive or legislative departments.’”¹⁷⁴

163 *Gupta v. SEC*, 796 F. Supp. 2d 503, 515 (S.D.N.Y. 2011).

164 See CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 13.

165 *Bebo* Memorandum, *supra* note 13, at 12–33.

166 *Hill*, 2015 WL 4307088, at *13.

167 See *Bebo* Memorandum, *supra* note 13, at 22 (emphasis added).

168 *Id.* at 25 (quoting *Mathews v. Eldridge*, 424 U.S. 319, 332 (1976)).

169 *Hill*, 2015 WL 4307088, at *13 (quoting U.S. CONST. amend. VII) (alteration in original).

170 *Id.* at *14 (quoting *Tull v. United States*, 481 U.S. 412, 420 (1987)).

171 *Id.*

172 *Id.*

173 *Id.* (quoting Defendant's Opposition to Plaintiff's Motion for a Temporary Restraining Order or, in the Alternative, a Preliminary Injunction at 17, *Hill v. SEC*, No. 1:15-CV-01801-LLM, 2015 WL 4307088 (N.D. Ga. June 8, 2015) (alteration in original)).

174 *Id.* (quoting *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 457 (1977)).

Defendants agree that the current issue involves a “public right;”¹⁷⁵ instead, they argue their right to a jury trial can only be taken away if “Congress is creating [a] ‘new public right.’”¹⁷⁶ The Northern District of Georgia reads *Atlas Roofing* in a different manner. The Court interprets *Atlas* to mean that “[f]or cases involving public rights, Congress has the choice as to whether or not a jury trial will be required.”¹⁷⁷ Therefore, the court held that Hill did not have a high likelihood of success on the merits.¹⁷⁸ There may be more to this argument, however.

First, as Justice Rehnquist wrote in his dissenting opinion in *Parklane Hosiery Co. v. Shore*, “[t]he founders of our Nation considered the right of trial by jury in civil cases an important bulwark against tyranny and corruption, a safeguard too precious to be left to the whim of the sovereign, or, it might be added to that of the judiciary.”¹⁷⁹ The right to a jury trial has historically been extremely important in the history of the United States.¹⁸⁰ Additionally, *Atlas Roofing* noted that the Court granted certiorari “under these circumstances,”¹⁸¹ referring to the circumstances “[w]here adjudicative responsibility rests only in the administering agency.”¹⁸² In the case of the SEC’s administrative proceedings, the adjudicative responsibility does not *only* rest in the administrative proceeding, because “the SEC’s authority in administrative penalty proceedings [is] coextensive with its authority to seek penalties in Federal court.”¹⁸³ Therefore, even if the Northern District of Georgia ruled that defendants in SEC administrative proceedings do not have the right to a jury trial, that does not mean that another district court could disagree in the future, or that a federal court of appeals would not find in favor of the defendant.

The second argument stems from the Fifth and Fourteenth Amendments, which guarantee defendants equal protection of the law.¹⁸⁴ In *Gupta*, the Southern District of New York, held that Gupta may have merit on his

175 *Id.*

176 *Id.* (quoting Reply Memorandum of Law in Further Support of Plaintiff’s Motion for a Temporary Restraining Order or, in the Alternative, a Preliminary Injunction at 17, Hill v. SEC, No. 1:15-cv-01801-LLM, 2015 WL 4307088 (N.D. Ga. June 8, 2015)).

177 *Id.*

178 *Id.* (“The Court does not find Plaintiff’s argument persuasive.”).

179 *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 343 (1979) (Rehnquist, J., dissenting).

180 *Id.* at 343 n.10 (“Thomas Jefferson stated: ‘I consider [trial by jury] as the only anchor yet imagined by man, by which a government can be held to the principles of its constitution.’” (quoting 3 THE WRITINGS OF THOMAS JEFFERSON 71 (H.A. Washington ed. 1861) (alteration in original))).

181 *Atlas Roofing Co. v. Occupational Safety & Health Review Comm’n*, 430 U.S. 442, 449 (1977).

182 *Id.* at 448 (quoting *Atlas Roofing Co.*, 518 F.2d at 990, 1011 (1975)).

183 H.R. 111-687, at 78 (2010) (Investor Protection Act of 2009).

184 U.S. CONST. amend. V; see *Bebo* Memorandum, *supra* note 13, at 22; see also *Weinberger v. Wiesenfeld*, 420 U.S. 636, 638 n.2 (1975) (stating that “[t]his Court’s approach to Fifth Amendment equal protection claims has always been precisely the same as to equal protection claims under the Fourteenth Amendment” (citing *Schlesinger v. Ballard*, 419 U.S. 498 (1975))).

claim, when he was one of twenty-nine Galleon-related defendants, and the only one whose case was brought in an administrative proceeding.¹⁸⁵ Clearly, he did not have the same protections under the law as the twenty-eight other Galleon-related defendants. The argument for current defendants is slightly different though.¹⁸⁶ In the cases of Bebo, Hill, and others similarly situated, there are not twenty-eight other defendants in the case who received the protections provided by federal district courts. But what makes Bebo and Hill different from other defendants in insider-trading cases brought by the SEC in federal district court? According to the SEC's released data for the year 2014, the SEC brought a total of fifty-two actions against individuals involved in insider-trading cases.¹⁸⁷ Of these fifty-two, twelve were brought as administrative proceedings, and the remaining forty were brought in federal district court.¹⁸⁸ The defendants assert that they are similarly situated to the forty defendants who had their cases heard in federal court, and they should be afforded the same protections afforded to those defendants.¹⁸⁹

If, in fact, the defendants are similarly situated, then the SEC cannot select a forum based on "an unjustifiable standard such as race, religion, or *other arbitrary classification*."¹⁹⁰ Currently, the SEC does not have a clear, bright-line rule on forum selection.¹⁹¹ Instead, according to Andrew Ceresney, Director of the SEC's Enforcement Division, the SEC makes its decision on "a case by case determination of which forum is appropriate based on the particular facts of the case."¹⁹² When the SEC can bring identical claims and receive identical penalties in either federal district court or an administrative proceeding, it appears the SEC is trying to get a home-court advantage, whenever it is beneficial to the SEC.¹⁹³ In conclusion, it is possible that a federal court of appeals or the Supreme Court could find that the defendants had their equal protection rights violated, even if district courts have recently held that the Appointments Clause issue is the only issue that may have merit.

The third and final argument the defendants asserted challenging the constitutionality of the SEC's administrative proceedings stems from the Fifth

185 See *Gupta v. SEC*, 796 F. Supp. 2d 503, 514 (S.D.N.Y. 2011).

186 *Id.* at 513 (stating that "even if the SEC were acting within its discretion when it imposed disparate treatment on Gupta that would not necessarily exculpate it from a claim of unequal treatment if the unequal protection was still arbitrary and irrational").

187 SEC, SELECT SEC AND MARKET DATA FISCAL 2014 3, <https://www.sec.gov/about/sec-stats2014.pdf> (last visited Feb. 13, 2016).

188 *Id.*

189 *Bebo* Memorandum, *supra* note 13, at 22.

190 *Oyler v. Boles*, 368 U.S. 448, 456 (1962) (emphasis added).

191 See SEC, FORUM SELECTION, *supra* note 94, at 1 ("There is no rigid formula dictating the choice of forum.").

192 Andrew Ceresney, Director, SEC Division of Enforcement, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297>.

193 See e.g., *Bebo* Memorandum, *supra* note 13, at 4.

Amendment as well.¹⁹⁴ The Fifth Amendment of the United States Constitution states that “[n]o person shall be . . . deprived of life, liberty or *property*, without due process of law.”¹⁹⁵ Additionally, “[p]rocedural due process imposes constraints on governmental decisions which deprive individuals of ‘liberty’ or ‘property’ interests within the meaning of the Due Process Clause of the Fifth or Fourteenth Amendment.”¹⁹⁶ In the case of cease-and-desist proceedings against defendants accused of insider trading, the penalties include disgorgement and civil penalties.¹⁹⁷ Therefore, “it is indisputable” that the defendants have “a property interest at stake in the administrative proceeding.”¹⁹⁸ In these cases, Charles Hill, Barbara Duka, and Lynn Tilton did not argue that their due process rights were violated in an administrative proceeding.¹⁹⁹ Laurie Bebo, however, did raise the issue, and the Eastern District of Wisconsin—affirmed by the Seventh Circuit—did not address the issue in its opinion because the court held that the federal district court did not have jurisdiction for the reasons stated above.²⁰⁰

Therefore, this is an issue that is still mainly unaddressed by the courts. When the SEC released its new proposed amendments, the only issues addressed were the due process issues, and even these did not provide the same level of procedural rights guaranteed in federal district courts.²⁰¹ Therefore, the question is, “[W]hat procedural mechanisms are required in order for the administrative proceeding to satisfy due process[?]”²⁰² In *Mathews v. Eldridge*, the Supreme Court held that

identification of the specific dictates of due process generally requires consideration of three distinct factors: First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government’s interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.²⁰³

194 See *id.* at 25–27.

195 U.S. CONST. amend. V (emphasis added).

196 *Mathews v. Eldridge*, 424 U.S. 319, 332 (1976).

197 See *Duka I*, 2015 WL 1943245, No. 15-CV-357, at *2 (S.D.N.Y. Apr. 15, 2015).

198 *Bebo* Memorandum, *supra* note 13, at 26.

199 See generally Plaintiff’s Supplemental Brief in Support of Plaintiff’s Motion for a Temporary Restraining Order, or, in the Alternative, a Preliminary Injunction, *Hill v. SEC*, No. 15-CV-01801 (N.D. Ga. June 2, 2015) (Doc. 21), 2015 WL 4185297; Reply Memorandum of Law in Support of Plaintiff Barbara Duka’s Motion for a Temporary Restraining Order and a Preliminary Injunction, *Duka v. SEC*, No. 15-CV-357 (S.D.N.Y. Feb. 9, 2015), 2015 WL 995695; Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial, *Tilton v. SEC*, No. 15-CV-2472 (S.D.N.Y. Apr. 1, 2015) (Doc. 1).

200 See generally *Bebo v. SEC*, 799 F.3d 765, 775 (E.D. Wis. Aug. 24, 2015).

201 See *supra* text accompanying notes 108–10.

202 See *Bebo* Memorandum, *supra* note 13, at 26.

203 424 U.S. 319, 335 (1976).

First, defendants being charged by the SEC for insider-trading cases have a strong private interest, as Justice Powell mentioned in his dissent in *Steadman v. SEC*.²⁰⁴ Second, the “risk of an erroneous deprivation of such interest”²⁰⁵ is extremely high. As previously mentioned, in the year 2014, the SEC won all of its cases brought in administrative proceedings compared to only sixty-one percent of the cases brought in federal district court.²⁰⁶ Third, the government continues to claim efficiency and effectiveness for the reasons as to why it deprives defendants of procedural rights guaranteed in federal district court.²⁰⁷ Still, as mentioned in *Hill*, “there is no evidence the SEC would be prejudiced by a brief delay to allow this Court to fully address [the] claims.”²⁰⁸

IV. WHY THE SEC SHOULD FIX ITS APPOINTMENTS CLAUSE ISSUES AND CONTINUE TO MODERNIZE ITS RULES OF PRACTICE TO ENSURE A FAIR AND EFFICIENT FORUM

In recent months, the SEC has received plenty of criticism concerning its increased use of administrative proceedings for cases involving non-regulated entities or persons.²⁰⁹ Whether due to this criticism or a different reason, the SEC’s enforcement division has released a guideline on forum selection, and the SEC Commissioners proposed amendments to its Rules of Practice.²¹⁰ As mentioned in the previous Part, however, there are still many issues that the SEC has either refused to address or has attempted to address and fallen short of procedural processes that are guaranteed to defendants in federal district court.²¹¹ This Part discusses a few recommendations on how the SEC can avoid future constitutional challenges and also recommendations that will ensure a fair and orderly process for all defendants. Similar to the United States Chamber of Commerce’s recommendations, the purpose of this Note is not to hinder the SEC’s enforcement division. However, in an effort “[t]o promote the financial stability of the United States,”²¹² defendants should *not* be deprived of their constitutional rights, especially when similarly situated cases are brought in federal district court when “it [is] advantageous as a litigation tactic to file there.”²¹³

204 *Steadman v. SEC*, 450 U.S. 91, 106 (1981) (Powell, J., dissenting) (stating that when a defendant is being charged with violating securities laws, in many respects it is similar to fraud, and “[i]t is clear . . . that the SEC’s finding of fraud and its imposition of harsh penalties have resulted in serious stigma and deprivation”).

205 *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976).

206 *See Rakoff*, *supra* note 2, at 7.

207 *Id.* at 6.

208 *Hill v. SEC*, No. 1:15-CV-01801, 2015 WL 4307088, at *19 (N.D. Ga. June 8, 2015).

209 *See supra* notes 9–19 and accompanying text.

210 *See supra* notes 94–110 and accompanying text.

211 *See supra* Section III.C.

212 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010).

213 *See Bebo Memorandum*, *supra* note 13, at 16.

A. *The SEC Should Follow the FTC and Fix Its Appointments Clause Issues*

Ultimately, a federal court of appeals and/or possibly the United States Supreme Court will decide whether SEC ALJs are inferior officers or employees. That does not mean, however, that the SEC should not go ahead and make changes to the appointments of its ALJs. Similar to the SEC, the FTC held that its ALJs are in fact employees and not inferior officers in a recent decision.²¹⁴ Additionally, the FTC ratified the appointment of its ALJs in order to avoid the issue in the future.²¹⁵ The SEC should follow the FTC and have the Commissioners appoint the ALJs to their position.

In the *Hill* decision, Judge May stated that the Appointments Clause issue would be an easy fix.²¹⁶ Additionally, in the *Duka* decision, Judge Berman originally only issued a seven-day injunction, while he waited to see if the SEC Commissioners would appoint its ALJs and avoid the entire issue.²¹⁷ The SEC, however, has stubbornly refused to have the Commissioners appoint the ALJs to avoid this entire issue.²¹⁸ Some people think that the SEC is concerned that if it gives in and corrects the issue, then it will reopen past administrative decisions.²¹⁹ Others don't see an issue with retroactivity,

214 See *In re LabMD, Inc.*, No. 9357, at *2 (FTC Sept. 14, 2015) (“Commission administrative law judges are . . . employees with limited authority; they are not ‘inferior officers’ subject to the Appointments Clause.” (quoting *Landry v. FDIC*, 204 F.3d 1125, 1133–34 (D.C. Cir. 2000))).

215 *Id.* (“Nonetheless, although we conclude that the Appointments Clause does not apply to the hiring of Commission administrative law judges, the Commission, purely as a matter of discretion, has ratified Judge Chappell’s appointment . . . as the Commission’s Chief Administrative Law Judge. This action by the Commission puts to rest any possible claim that this administrative proceeding violates the Appointments Clause.”).

216 See *Hill v. SEC*, No. 1:15-CV-01801-LLM, 2015 WL 4307088, at *20 (N.D. Ga. June 8, 2015) (“[T]his conclusion may seem unduly technical, as the ALJ’s appointment could easily be cured by having the SEC Commissioners issue an appointment or preside over the matter themselves.”).

217 *Duka II*, No. 15 Civ. 357 (RMB) (SN), 2015 WL 4940083, at *3 (S.D.N.Y. Aug. 12, 2015).

218 Letter from Preet Bharara, U.S. Attorney, et al., to the Honorable Richard M. Berman, U.S. Dist. Judge 1 (Aug. 10, 2015), <https://securitiesdiary.files.wordpress.com/2014/11/sec-response-to-judge-richard-berman-re-appointment-of-aljs.pdf> (“Although the Commission in its adjudicatory capacity may decide in due course whether SEC ALJs’ appointments violate the Constitution and, if so, the appropriate remedy for such a violation, as of the filing of this letter, the Commission has not issued a decision or otherwise taken any public action on these questions.”). Note that since this letter, the Commission did decide the question in *In re Lucia*, and the Commission held that the ALJs were employees and not inferior officers. Therefore, they were not in violation of the Appointments Clause. *In re Lucia Cos., Inc.*, No. 3-15006, at *28 (U.S. Sec. & Exch. Comm’n Sept. 3, 2015).

219 Eaglesham, *SEC Fights*, *supra* note 16 (“Thomas McCarthy, a past president of the Federal Administrative Law Judges Conference, an association of in-house judges for the SEC and other government agencies, said in an interview the wrangles could ‘open a can of worms’ by calling into question hundreds of administrative law judges’ decisions across government.”). *Contra* Jean Eaglesham, *Federal Judge SEC In-House Judge’s Appointment ‘Likely Unconstitutional’*, WALL ST. J. (June 8, 2015), <http://www.wsj.com/articles/federal->

stating, “When it’s done, it’s done,” and presenting the question why is the SEC “doing all of this?”²²⁰ The SEC should fix this problem, and there is a straightforward solution. The Commissioners were deemed the head of the department in *Free Enterprise Fund*,²²¹ therefore, the Commissioners have to appoint the ALJs, and then the SEC can continue with its administrative proceedings in *Duka* and *Hill*—instead of going through the federal appeals process. Additionally, because a federal court of appeals would not hear the case, past defendants will not be able to point to a federal court of appeals decision that holds that the past appointments procedures were unconstitutional. This should benefit the SEC in cases appealing a prior, adverse decision. Even if retroactivity becomes an issue in the future, it is still beneficial for the SEC to ratify the appointments of its ALJs. This will protect the current decisions made by ALJs in an administrative proceeding, so that in the future, the decisions will not be challenged. Therefore, it will allow the SEC to move past this recent criticism and return to its mission to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”²²²

B. The SEC Needs to Follow a “Rigid Formula” When Selecting Its Forum to Prevent Violation of the Equal Protection Clause—Especially in Regard to Non-Regulated Entities or Persons

Historically, the SEC has had two options when deciding which forum to bring an action in. First, the SEC could bring its case in-house in an administrative proceeding before an ALJ. Or second, the SEC could bring a civil action in federal district court.²²³ Some of the civil penalties are only obtainable through an administrative proceeding, and it makes sense to bring those cases in an administrative proceeding.²²⁴ However, now that the SEC can bring similar cases against non-regulated individuals and/or entities in either a federal district court or in an administrative proceeding, it has raised the question how the SEC should select its forum.

Currently, the SEC has no formula on how to select its forum, and it admits this much in its recently released *Division of Enforcement Approach to Forum Selection in Contested Actions*.²²⁵ Unsurprisingly, this has led defendants to claim that the SEC is simply shopping for whichever forum provides it with the highest chance of winning—and if this is the goal, the SEC has accom-

judge-rules-sec-in-house-judges-appointment-likely-unconstitutional-1433796161 (“SEC officials don’t think rulings by agency judges . . . would be open to challenges in this way, in part because the agency’s commissioners sign off on the final decision . . .”).

220 See Alison Frankel, *Unlike SEC, FTC Makes Quick Fix to Ward Off ALJ Constitutional Challenges*, REUTERS (Sept. 16, 2015), <http://blogs.reuters.com/alison-frankel/2015/09/16/unlike-sec-ftc-makes-quick-fix-to-ward-off-alj-constitutional-challenges/>.

221 See generally *Free Enter. Fund v. PCAOB*, 130 S. Ct. 3138 (2010).

222 *What We Do*, *supra* note 27.

223 See Rakoff, *supra* note 2, at 3.

224 *Id.*

225 See SEC, FORUM SELECTION, *supra* note 94, at 1.

plished it, given its high success rate in administrative proceedings.²²⁶ Therefore, it is imperative that at a minimum, the SEC creates a rigid formula on how it will select its forum. Even better would be if the SEC followed the recommendations proposed by the United States Chamber of Commerce, which would allow any defendant in an administrative proceeding to move the case to a federal district court in order to have a right to a jury trial.²²⁷ Although, even if the more radical changes are not followed, the SEC needs to be clear and explicit with how it selects its forum in order to avoid equal protection claims and also to be fair to defendants.

When creating a rigid formula to follow, the SEC has already laid out the framework in its *Division of Enforcement Approach to Forum Selection in Contested Actions*. For instance, under the category of “[f]air, consistent, and effective resolution of securities law issues and matters,” the enforcement division says that it will consider whether “a contested matter is likely to raise unsettled and complex legal issues.”²²⁸ Therefore, the SEC is already considering this factor; it also states, however, that “the Division may in its discretion” consider whichever factors it would like to consider.²²⁹ This factor should be dispositive, and if the case raises “unsettled and complex legal issues,”²³⁰ then the SEC should be required to bring the case in federal district court. This would prevent the SEC from creating new laws that would need to be followed by a court of appeals—similar to what happened in *VanCook v. SEC*, where the Second Circuit upheld an ALJ’s interpretation of the law over a federal court’s interpretation because of *Chevron* deference.²³¹ I can hardly imagine Congress intended for the SEC’s ALJs to have the ability to create new laws,²³² and this solution would also ease Judge Rakoff’s concerns presented in his speech at the PLI Securities Regulation Institute in 2014.²³³

Other factors that the SEC needs to include in its “rigid formula” are also included as current factors that may be considered under the SEC’s cur-

226 See *supra* notes 12–23 and accompanying text.

227 See CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 4.

228 SEC, FORUM SELECTION, *supra* note 94, at 3.

229 *Id.* at 1.

230 *Id.* at 3; see also CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 3 (stating that the SEC should consider whether “[t]he proceeding is based upon well-established legal principles that have been adopted by Article III courts”).

231 See *VanCook v. SEC*, 653 F.3d 130, 140 n.8 (2d Cir. 2011) (stating that the SEC’s “interpretation of Rule 10b-5 ‘trumps’ our prior interpretation” (quoting *Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 982 (2005))); see also *Chevron U.S.A. Inc., v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 866 (1984) (“When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency’s policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail.”).

232 See *Atkins & Bondi*, *supra* note 32, at 393 (“Congress took comfort in the fact that federal judges would operate as an independent check to the Commission’s decision to seek an issuer penalty and the amount sought to be recovered.”).

233 See Rakoff, *supra* note 2, at 12 (“I would urge the S.E.C. to consider that it is neither in its own long-term interest, nor in the interest of the securities markets, nor in the interest of the public as a whole, for the S.E.C. to become, in effect, a law unto [sic] itself.”).

rent guidelines for forum selection. For instance, one of the factors listed is “[t]he availability of the desired claims, legal theories, and forms of relief in each forum.”²³⁴ This factor refers to the SEC’s ability to bring “charges of failure to supervise or causing another person’s violation [that] can *only* be pursued in the administrative forum.”²³⁵ We can compare this with requesting an injunction to immediately stop a person’s actions, which the SEC can only bring in federal district court.²³⁶ Again, this factor should be dispositive, and it fits in perfectly with a rigid formula. Another factor that should be dispositive—rather than just a consideration—is whether the defendant is a regulated person or entity. Historically, the SEC could only charge non-regulated persons or entities in federal district court—and the ability to impose civil monetary penalties against non-regulated persons or entities is a relatively modern expansion of power.²³⁷ The Dodd-Frank Act, however, allowed the SEC to impose civil monetary penalties against non-regulated persons or entities through an administrative proceeding.²³⁸ Ideally, the SEC would implement a rigid formula that says it will bring all cases against non-regulated persons or entities in federal district court. Considering that the SEC is unlikely to give up this increased power willingly,²³⁹ Congress may need to address this factor. Congress should consider revising and amending the portion of the Dodd-Frank Act that allows the SEC “to bring almost all enforcement actions as either an administrative proceeding or as a civil action.”²⁴⁰ The problem with giving the SEC this discretion is that it allows the SEC to abuse this authority and allows it to forum shop based on whichever forum is more beneficial, as compared to whichever is more fair.

The other factor the SEC mentions in its *Division of Enforcement Approach to Forum Selection in Contested Actions*, states that the enforcement division considers “[t]he cost-, resource-, and time-effectiveness of litigation in each forum.”²⁴¹ Although having a fast, efficient forum is important, this factor should not be dispositive, because the elements of fairness should outweigh this factor. When a defendant has the possibility of losing “property,” they

234 See SEC, FORUM SELECTION, *supra* note 94, at 1; see also CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 3 (stating that the SEC should consider whether “[t]he staff is alleging a cause of action that may be brought only in an administrative proceeding”).

235 SEC, FORUM SELECTION, *supra* note 94, at 1 (emphasis added).

236 *Id.*

237 See *supra* Part I.

238 CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 12.

239 Rakoff, *supra* note 2, at 5–6 (“This sea-change has come about almost entirely at the request of the S.E.C., usually by tacking the provisions authorizing such expansion onto one or another statute enacted in the wake of a financial scandal.”).

240 CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 3.

241 SEC, FORUM SELECTION, *supra* note 96, at 2–3. *Contra* CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 18 (“It should also adopt a procedural mechanism to enable a possible respondent to challenge the application of these principles to a specific matter, in a way that is fair and that does not unduly delay the proceeding or impose awkward adjudicative duties on an ALJ.”).

are guaranteed the right to due process under the Fifth Amendment to the Constitution.²⁴² Therefore, with the current differences between the choice of forums, the fairness factors should play a larger role in the SEC's decision rather than the cost and the time the trial will take in comparison to the administrative proceeding. Overall, the goal of a rigid formula should be to prevent the SEC from arbitrarily selecting its forum based on where it thinks it has the best chance of winning and to ensure a fair process for all parties involved.

C. *The SEC Needs to Amend Its Rules of Practice to Conform More with Federal Rules in District Courts*

This last recommendation is directly analogous to the fourth recommendation proposed by the United States Chamber of Commerce.²⁴³ It is important to note that since the United States Chamber of Commerce published its recommendations, the SEC has proposed amendments to its Rules of Practice.²⁴⁴ These proposed amendments, however, do not do enough to ensure defendants have a fair trial and receive all of their protections under procedural due process. According to Robert Khuzami, former Director of Enforcement at the SEC, the only reason the SEC gave for an expansion of enforcement policies against non-regulated persons or entities in the Dodd-Frank Act was for “effectiveness and efficiency.”²⁴⁵ Therefore, when applying the three factors from *Mathews*—mentioned earlier—the only “governmental interest[]”²⁴⁶ is “effectiveness and efficiency.”²⁴⁷ This poses the question: Are federal courts willing to forfeit fairness for efficiency?

The SEC's proposed amendments to its Rules of Practice provide significantly more procedural rights for defendants than they were provided before. There are a few issues, however, that should still be addressed. For instance, the proposed amendment explicitly states that the Commission is seeking to clarify rules concerning the admittance of hearsay. By clarifying, the Commission “propose[s] to add Rule 320(b) to clarify that hearsay *may be admitted* if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair.”²⁴⁸ Therefore, by “clarifying,” the SEC is directly stating that hearsay—which is banned in federal courts through the Federal Rules of Evidence²⁴⁹—can be admitted in an administrative proceeding.

This proposed rule is still unsatisfactory, especially when put in context of the other rules. For instance, the proposed amendments allow defendants

242 U.S. CONST. amend. V.

243 See CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 4.

244 See generally SEC, AMENDMENTS, *supra* note 23, at 3 (proposing adjustments to administrative proceedings to allow for discovery devices to “introduce additional flexibility . . . while still providing for the timely and efficient disposition of proceedings”).

245 See Rakoff, *supra* note 2, at 6.

246 *Mathews v. Eldridge*, 424 U.S. 319, 340 (1976).

247 See Rakoff, *supra* note 2, at 6.

248 See SEC, AMENDMENTS, *supra* note 23, at 16–18 (emphasis added).

249 See FED. R. EVID. 802.

to “file notices to depose three persons.”²⁵⁰ This is a major improvement over the previous rule, where defendants could only take an oral deposition if the person could not attend the hearing.²⁵¹ In contrast, the Federal Rules of Civil Procedure allow for up to ten depositions without leave, and even more with leave.²⁵² The main problem is that the SEC can spend years investigating the defendants, during which the SEC has the ability to issue subpoenas for documents and testimony.²⁵³ Without providing defendants a chance to depose more individuals, however, the only information they can use in court is the information provided by the SEC and the three individuals they can depose.²⁵⁴ This provides issues with whom to depose out of all of the possible witnesses, and may not lead to the results needed to show innocence on the part of the defendant. Additionally, if the SEC is permitting hearsay, the defendants may not be able to properly depose and contradict witnesses who are citing potentially unreliable sources.²⁵⁵ Additionally, the SEC amendments could follow many of the rules already published in the Federal Rules of Civil Procedure and Federal Rules of Evidence, which are already being used in federal courts. Therefore, in order to promote fairness and prevent constitutional due process concerns, the SEC should propose additional amendments to align more closely with the Federal Rules of Civil Procedure and the Federal Rules of Evidence.

CONCLUSION

The SEC should fix its Appointments Clause issue, create a rigid formula for its forum selection, and add additional amendments to its Rules of Practice to conform more to the procedural rights in federal district courts. Although the SEC was granted the right to bring complex insider-trading cases in administrative proceedings rather than federal district courts through the Dodd-Frank Act, the increased use of administrative proceedings and timing of its decision to bring more cases internally led to much criticism.²⁵⁶ The SEC is an organization tasked with protecting markets and investors. If the procedures used by the SEC are called into question, however, the effectiveness of its practice may also be called into question,²⁵⁷ which would cause more harm than good. Therefore, it is important that the SEC take the recent criticism seriously.

250 SEC, AMENDMENTS, *supra* note 23, at 7.

251 *Id.*

252 FED. R. CIV. P. 31(a)(1)–(2).

253 See CHAMBER OF COMMERCE, RECOMMENDATIONS, *supra* note 22, at 53 (finding that only sixteen percent of “[f]ormal” investigations were resolved in a year or less, while fifty-nine percent of “formal” investigations took three to five years or longer).

254 See Henning, *supra* note 17.

255 *Id.*

256 See *supra* notes 9–19 and accompanying text.

257 See *supra* note 18 and accompanying text.

In order to fix the Appointments Clause issue, the Commissioners of the SEC need to appoint—or, as the FTC did, ratify the appointment of²⁵⁸—the current SEC ALJs who were not appointed by the SEC Commissioners. This should be a relatively simple adjustment to implement, and as with many of the defendants who agree to settlements with the SEC, they do not even have to admit wrongdoing. Ideally, this would not affect past decisions, but even if it does, it will protect future decisions made by ALJs from being challenged by what Judge May calls an “unduly technical” decision.²⁵⁹ Additionally, by providing clear guidelines for which cases are brought in federal district court as compared to internally within the SEC, the SEC will show investors and companies that the processes used by the SEC are in fact fair and provide defendants with a clear, unambiguous notice of which forum will hear their charges. The final recommendation seeks to improve on the recent amendments made by the SEC. Similar to the Federal Rules of Evidence, hearsay should not be included in administrative proceedings, because hearsay will not make a proceeding more efficient, and it will unduly prejudice the defendant. Further, defendants deserve more comprehensive pre-discovery rights, which could easily be accomplished by listing factors in which defendants can request additional depositions, similar to the Federal Rules of Civil Procedure. With these changes, the SEC can return to its overall mission to “protect investors, maintain fair, orderly, and efficient markets, and to facilitate capital formation,”²⁶⁰ without being criticized in the *Wall Street Journal* on a regular basis.

258 See *In re LabMD, Inc.*, No. 9357, at 2 (FTC Sept. 14, 2015).

259 See *Hill v. SEC*, No. 1:15-CV-01801, 2015 WL 4307088, at *20 (N.D. Ga. June 8, 2015).

260 *What We Do*, *supra* note 27.